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Nashua, New Hampshire; General Obligation

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Credit Profile		
US\$22.455 mil GO Refunding Bonds ser 2012 due 03/15/2024		
Long Term Rating	AA+/Stable	New
Nashua GO		
Long Term Rating	AA+/Stable	Affirmed
Nashua GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Rationale

Standard & Poor's Ratings Services has assigned its 'AA+' long-term rating to Nashua, N.H.'s series 2012 general obligation (GO) refunding bonds and affirmed its 'AA+' long-term rating and underlying rating (SPUR) on the city's existing GO debt. The outlook is stable.

The 'AA+' rating reflects our assessment of the city's:

- Diverse local economy, with significant high-tech, defense, health care, and retail employment;
- Strong income and wealth indicators;
- Record of conservative budgeting and a strong financial position; and
- Low tax-supported debt burden, net of self-supporting GO debt.

The city's full faith and credit GO pledge secures the bonds. We understand that officials will use bond proceeds to refund a portion of the city's series 2004 GO bonds.

Nashua, with an estimated population of 86,000, is located in southern New Hampshire, 34 miles northwest of Boston. In the past few decades, as the city has transitioned away from textile manufacturing, the city's economic growth has been fueled by the development of a deep local and regional employment base, featuring high-tech and defense manufacturers and health care providers. The city's location near the Massachusetts border coupled with New Hampshire's lack of a sales tax has fostered a strong commercial and retail presence in the city, as demonstrated by the city's per capita retail sales, which were 200% of the national average in 2010.

The typically higher paying sectors in the city contribute to its good income levels, with household effective buying income of 126% of the national average and per capita effective buying income equal to 124%. City unemployment has historically been below the national average but has tracked slightly higher than the statewide rate; as of December 2011, the city's rate was 5.7% (seasonally unadjusted), considerably below the national average of 8.5% but above the statewide rate of 4.9%. BAE Systems--a manufacturer of aerospace electronics and a division of Lockheed Martin Corp.--is the largest private employer with 2,800 workers in the city. Other large employers include the city (2,800 employees), Southern New Hampshire Medical Center (2,200), and the St. Joseph Hospital and Trauma Center (1,990). The city's tax base has achieved minimal growth since a revaluation in fiscal 2010 resulted in a 10% decrease in net assessed valuation. Nevertheless, tax base value remains strong on a per capita basis at \$100,000.

While the tepid economic recovery and state assistance cuts continue to pressure its revenue base, Nashua's financial position remains strong, in our opinion, and officials continue to manage within the constraints of its locally adopted charter amendment, limiting budget growth to the average of the previous three years' Consumer Price Index growth. The city ended fiscal 2011 (June 30) with a \$4.4 million net deficit, but operations were breakeven after accounting for planned one-time capital transfers. Nashua reported a favorable general fund budget-to-actual expenditure variance of \$4 million (1.7%), but an unfavorable variance of \$1.4 million (0.6%) on revenues, largely driven by interest earnings \$1 million below budget.

The year-end total fund balance was \$46 million, \$25.5 million of which is unassigned, equivalent to what we consider a strong 11% of operating expenditures and above the city's 10% minimum threshold policy. Cash levels remains good: net of an \$85.5 million prepaid property tax liability (the first semiannual property tax payment for the succeeding fiscal year is due by July 1), the city reported nearly \$47 million of cash and short-term investments on its year-end governmental funds balance sheet, equivalent to 63 days' expenses. We understand the city has not borrowed for cash-flow purposes since the implementation of semiannual property tax billing in 1972. Property taxes are the city's primary revenue source at 72% of 2011 general fund revenues; collections remain strong and have been consistently more than 98% annually on a current basis.

The 2012 operating budget totals \$227 million, a 1.7% increase over 2011 and below the budget year's growth cap of 2%. Expenditure savings were achieved through across-the-board departmental operating cuts of 3%, with the exception of the school division, for which spending was held flat. The city also instituted changes to its medical plan offerings and increased employee benefit contributions. Officials report no notable variations on revenues or expenditures through February. Nashua's financial management practices are still considered "good" under Standard & Poor's Financial Management Assessment methodology, indicating formal practices exist in most areas.

After accounting for utility self-support and state support of school debt, Nashua's overall debt burden is low, in our opinion, at \$1,500 per capita and 1.4% of market value. Carrying charges have averaged approximately 7% annually over the past three audited fiscal years and are budgeted at 7.7% of spending for fiscal 2012. The city has \$89 million of authorized but unissued debt but we understand it does not have plans for new money debt issuance until fiscal 2013. The six-year capital improvement plan includes \$122 million of projects, of which \$72 million are slated to be supported by the governmental funds.

The city makes annual contributions to the state retirement system, which covers all full-time workers except public works employees. Beginning in fiscal 2012, the state completely eliminated its partial subsidy of retirement system costs for teachers, firefighters, and police. As a result, the city's required contribution for fiscal 2012 increased 23% to \$14.6 million, but at 6.4% of budget, we believe this cost remains manageable. The city's other postemployment benefits (OPEB) unfunded liability of \$42 million is incurred primarily from the implicit subsidy of retirees purchasing health insurance at 100% of the premium cost.

In January 2012, the city issued \$151 million of taxable general obligation bonds to finance the acquisition of Pennichuck Corp., a private water utility serving the city of Nashua and a number of other surrounding communities. Nashua officials expect the acquisition bonds to be self-supporting from water utility revenues. However, even if the city was forced to assume the entire \$8.8 million in annual debt service payments on the GO acquisition bonds, we believe the impact on the city's finances would be manageable. We estimate that the city would need to increase its current millage levy roughly 5% to cover the annual debt payments and the city's tax-supported debt service carrying charges would rise to roughly 12% of budget, a level we still consider moderate.

Furthermore, the city's debt burden would increase but remain moderate at slightly more than 3% of market value and \$3,200 per capita.

Outlook

The stable outlook reflects Standard & Poor's expectation that Nashua will maintain a strong financial position, characterized by healthy reserves and good liquidity. The deep and diverse local economy is also a strength and provides additional stability to the rating. The city expects the Pennichuck acquisition bonds to be self-supporting and we will continue to monitor the financial health of the water utility. In the near-term, we believe the city's general financial position has not been materially affected by the acquisition and the city has the capacity to absorb the costs of the debt should it need to in the future. Further, the merger has strong community, legislative, and regulatory support, which we believe is important to its long-term viability.

Pennichuck Acquisition

The Pennichuck acquisition was the culmination of a decade-long effort by the city to acquire the assets owned by Pennichuck, which city officials report was driven by the city's desire to control and protect its critical water resources. In 2003, via special referendum, city voters approved the effort to acquire the utility by eminent domain. However, in the latter half of the 2000s, the city moved to purchase Pennichuck through merger, which officials felt offered a more favorable outcome than eminent domain, primarily because the costs of acquisition were lower; the system would remain consolidated as one entity; and, through this method, the city would control all land in its watershed.

In January 2011, pursuant to a settlement agreement approved by the New Hampshire Public Utility Commission (NHPUC) and legislation authorized by the state legislature, the city acquired 100% of the outstanding shares of Pennichuck, including its five subsidiaries, three of which are regulated water utilities. The city used proceeds from the GO acquisition bonds to pay all transaction costs, including an equity contribution of \$30 million and a \$120 million note between Pennichuck and the city that Pennichuck is obligated to repay with interest monthly over a period of 30 years. The city will also receive monthly dividend payments from Pennichuck, which, in tandem with the note payments, will be used to be pay debt service on the city's GO acquisition bonds.

The settlement agreement established a special ratemaking structure designed to ensure the generation of revenues sufficient to cover all operating, capital, and debt service costs (including note and dividend payments to the city) of Pennichuck and its subsidiaries. It also facilitated the creation of a \$5 million rate stabilization fund to provide additional liquidity in the event operating revenues are not sufficient for Pennichuck to meet its obligations to the city. If the fund needs to be used, rates will be adjusted so that it is fully replenished over a three-year period.

Pennichuck Corp. remains a separate legal entity from the city, and the three water utilities continue to be regulated by the NHPUC. The city is the sole shareholder of the corporation, which is now governed by an independent board of directors. However, we understand there has been no change in Pennichuck's day-to-day operating management as result of the acquisition. The new board is limited to a maximum of 13 members and is required to have at least five city residents and one member from another Pennichuck service area outside the city. Elected officials and family members are restricted from serving on the board, with the exception of the city's mayor, who will serve an initial two-year term only. New board members are subject to approval by the Nashua Board of Aldermen. The

aldermen must approve any future borrowing or substantial transaction by Pennichuck, which ensures the city will have the ability to actively manage the financial health of the utility.

Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

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